No. 12026

In the United States Circuit Court of Appeals for the Ninth Circuit

UNITED STATES OF AMERICA,
Appellant,

vs.

IRENE ETHEL LAMBETH,
Appellee.

On Appeal from the United States District Court
for the District of Oregon

BRIEF FOR THE UNITED STATES

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Assistant Attorney General.
ELLIS N. SLACK,
ROBERT N. ANDERSON,
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INDEX

Statute:

Miscellaneous:

Treasury Regulations 43:

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OPINION BELOW

The District Court did not file a written opinion.

JURISDICTION

This appeal involves carbaret admissions taxes and interest thereon, imposed by Section 1700(e) of the Internal Revenue Code, as amended by Section 622 of the Revenue Act of 1942, for the period September 17, 1943, until July 31, 1944, in the total amount of $6,538.21.[1] (R. 9.) The taxes in dispute were paid on September 18, 1944. (R. 8.) A claim for refund was filed by the taxpayer on September 28, 1944. (R. 8.) The claim was rejected by the Commissioner of Internal Revenue by notice dated February 11, 1946. (R. 8.) On December 18, 1947, within the time provided by Section 3772 of the Internal Revenue Code, the taxpayer instituted an action in the District Court for the recovery of the taxes and interest paid. (R. 2-4.)

Jurisdiction was conferred on the District Court by Section 24, Twentieth, Judicial Code. Judgment was entered

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(1) The cabaret taxes sought to be recovered in taxpayer's complaint amounted to $6,917.91, and covered the period May 1, 1943, through July 31, 1944. (R. 4.) The Government has now conceded that the taxpayer is entitled to recover the cabaret taxes and interest assessed for the period May 1, 1943, to September 17, 1943, in the aggregate amount of $379.70, plus statutory interest.

on April 27, 1948. (R. 17.) Within sixty days thereafter and on June 26, 1948, notice of appeal was filed. (R. 18-19.) The jurisdiction of this Court is invoked under 28 U.S.C., Sec. 1291.

QUESTION PRESENTED

Whether the District Court erred in holding that during the period involved the taxpayer was not operating a roof garden, cabaret or other similar place furnishing a public performance for profit within the meaning of Section 1700(e) of the Internal Revenue Code, as amended.

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code:

> SEC. 1700. TAX.
> There shall be levied, assessed, collected, and paid—
>
> * * * * *
>
> (e) [as amended by Section 622 of the Revenue Act of 1942, c. 619, 56 Stat. 798.[2]] *Tax on Cabarets, Roof Gardens, Etc.*—
>
> (1) *Rate.*—A tax equivalent to 5 per centum[3]

(2) The effective date of this amendment was November 1, 1942.

(3) This rate was changed by Section 1650 of the Internal Revenue Code, as added by Section 210 of the Revenue Act of 1940, c. 419, 54 Stat. 516, and amended by Section 302(a) of the Revenue Act of 1943, c. 63, 58 Stat. 21.

of all amounts paid for admissions, refreshment, service, or merchandise, at any roof garden, cabaret, or other similar place furnishing a public performance for profit, by or for any patron or guest who is entitled to be present during any portion of such performance. The term "roof garden, cabaret, or other similar place" shall include any room in any hotel, restaurant, hall, or other public place where music and dancing privileges or any other entertainment, except instrumental or mechanical music alone, are afforded the patrons in connection with the serving or selling of food, refreshment, or merchandise. A performance shall be regarded as being furnished for profit for purposes of this section even though the charge made for admission, refreshment, service, or merchandise is not increased by reason of the furnishing of such performance. No tax shall be applicable under subsection (a) (1) on account of an amount paid with respect to which tax is imposed under this subsection.

(2) *By whom paid.*—The tax imposed under paragraph (1) shall be returned and paid by the person receiving such payments.

* * * * *

(26 U.S.C. 1946 ed., Sec. 1700.)

Treasury Regulations 43 (1941 ed.):

SEC. 101.13 [as amended by T. D. 5349, 1944 Cum. Bull. 639]. *Basis, rate, and computation of tax.*—The tax imposed by section 1700(e), as amended, applies to all amounts paid for admission, refreshment, service, and merchandise, at any roof garden, cabaret, or other similar place furnishing a public performance for

profit, by or for any patron or guest who is entitled to be present during any portion of such performance.

* * * * *

SEC. 101.14 [as amended by T. D. 5192, 1942-2 Cum. Bull. 249]. *Scope of tax.* — The term "roof garden, cabaret, or other similar place" includes any room in any hotel, restaurant, hall, or other public place where music and dancing privileges or any other entertainment, except instrumental or mechanical music alone, are afforded the patrons in connection with the serving or selling of food, refreshment, or merchandise. A public performance furnished at a roof garden, cabaret, or other similar place shall be regarded as being furnished for profit for purposes of this section even though the charge made for admission, refreshment, service, or merchandise is not increased by reason of the furnishing of such performance.

Where music, whether by an orchestra, a mechanical device, or otherwise, and a space in which the patrons may dance is furnished in the dining room of a hotel, or in a restaurant, bar, etc., the entertainment constitutes a public performance for profit at a roof garden, cabaret, or similar place, and the payments made for admission, refreshment, service, and merchandise are subject to the tax.

Amounts paid for refreshment, service, or merchandise in a room which is entirely separate from the room in which entertainment is furnished are not subject to tax, provided that the patrons in such separate room may not witness the entertainment and any door in the wall or partition separating the two rooms remains closed during the period of the entertainment except when persons pass from one room to the other.

* * * * *

STATEMENT

The material facts may be summarized as follows:

At all times here involved the taxpayer was a resident of Portland, Oregon. (R. 13.) In October, 1941, the taxpayer became connected with the Cozy Club (R. 15, 38), at or about which time she entered into an agreement with a Mr. Church, the then manager of the club, to take over the management thereof (R. 39). At that time, she purchased equipment used by the club and then owned by Mr. Church. (R. 39.) Under the arrangement, it was agreed that in consideration of operating the club, the taxpayer was to receive the entire profits derived from the sale of beverages and food, and that she would be responsible for the payment of all expenses incurred. (R. 40.)

Originally, the Cozy Club was located at 1017 Southwest Sixth Avenue, Portland, Oregon. (R. 41.) It continued to operate at that location after the taxpayer took over its management until May 18, 1943, when the club quarters were moved to 929 Southwest Yamhill Street (R. 45), where the taxpayer operated the club after that date and during the period here involved under the name of the La Fiesta Club (R. 53).

When the taxpayer originally took over the management of the club and up to September 17, 1943, it was operated under a so-called service liquor license issued by the Ore-

gon State Liquor Control Commission, under which type of license dancing was not permitted. (R. 45-46.) No license was ever issued by the Commission permitting the Cozy or La Fiesta Club to operate as a private club. (R. 123-127.) Prior to September 17, 1943, no dancing facilities were furnished by the taxpayer at either place.[4] (R. 48.) On September 17, 1943, taxpayer obtained a restaurant license in connection with the operation of the club at 929 Southwest Yamhill Street, under which license she was permitted to operate a public restaurant. (R. 48.) Under this license persons were allowed to dance. (R. 48-49, 74.) After that date and during the entire period involved, the taxpayer furnished dancing facilities and dancing was allowed. (R. 48-49, 74, 133.) Music for dancing was furnished in the dining room of the club by a mechanical machine playing records, commonly called a juke box. (R. 47.) The seating capacity of the dining room was eighty-seven persons. (R. 131.)

The LaFiesta Club quarters were located on the second

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(4) The record is not clear as to when music and dancing facilities were first furnished between May 1, 1943, and September 17, 1943. (R. 48, 112-114, 132-133.) Since it appears that dancing was not permitted under the service license under which taxpayer operated prior to September 17, 1943 (R. 48), the Government has conceded that no dancing was allowed in the club prior to that date. (See Footnote 1.)

floor of the building situated at 929 Southwest Yamhill Street. (R. 46.) They contained complete restaurant facilities, including barroom, check room, dining room, kitchen, lockers and necessary plumbing, the total area of which was approximately 2,500 square feet. (R. 46, 49.) Access thereto was by a stairway, at the bottom of which was a swinging double door, and at the top of which was a large, heavy bolted door, which could only be opened by a push button on the inside. (R. 47.)

Membership cards introduced in evidence indicated that a charge of $3 per year was made as dues to members. (R. 58.) Membership in the club could be applied for by persons who were asked to join the club, usually by someone who had previously brought the prospective member to the club as a guest. (R. 56.) Applications for membership were passed on by the taxpayer and a Mrs. Sherman, who was secretary-treasurer (R. 56-57), and the record clearly indicates that almost anyone who conducted himself as a guest in a satisfactory manner could become a member by making application therefor (R. 57-58.) During the early part of 1944, enlisted personnel of the military forces were permitted to obtain a membership by the payment of only fifty cents. (R. 59.) R. H. Lambeth, president of the club after June, 1944, testified that this policy was adopted because "enlisted men had very little places that they could take their friends, their girl friends, to a place where they

could drink and dance, if necessary, and we thought perhaps we would reduce the amount that they would have to pay, that is, the membership * * * and allow them to come in under military membership." (R. 104.) He also testified that the club could not have remained in business unless additional membership from this source was obtained. (R. 105-106.) Many of these military memberships were secured through guest cards which were passed out by Military Police. (R. 88.) The club was frequented by sailors and soldiers every day during the period involved, who gained admission on their first visit by use of a guest card, and once admitted as a guest, they could immediately make application and obtain a membership. (R. 89.) The only manner in which applications were judged and passed upon was with respect to their conduct as guests which, if good, was sufficient to qualify them as members. (R. 90.) Mrs. Edith L. Deck, a witness for the taxpayer, testified that she and her husband became members of the club on their own application without being introduced by a member. (R. 78.)

Members were permitted to bring two guests to the club, but if a member brought more than two guests, a cover charge of seventy-five cents was made for each extra guest. (R. 93, 129-130.) This usually occurred on Friday and Saturday nights. (R. 94, 135.) On the basis of the cover charges collected from guests in excess of two on Friday and Saturday nights from September, 1943, through May,

1944, an average of approximately forty extra guests were present on each of those nights during that period. (R. 130, 135.) It would thus appear that the number of members and guests present each Friday and Saturday night during the period involved was enough to fill the capacity of the dining room, namely eighty-seven persons. (R. 131.)

The club had no bank account separate and apart from the taxpayer's bank accounts. (R. 50.) Money received from membership fees and dues was deposited in taxpayer's special account and used to reimburse her for money advanced for remodeling and decorating the club premises. (R. 40, 50.) During the period involved, the taxpayer received all income from the club operations, including the proceeds from the sale of alcoholic beverages, food, slot and mechanical music machines (R. 40, 131-132), and after paying all expenses of operations (R. 40), retained the profit (R. 49). Taxpayer also maintained books of accounts showing her gross receipts of the club upon which the amount of the cabaret taxes involved herein was determined. (R. 131-132.) Considerable amounts were spent by the taxpayer for advertising and a neon sign was erected outside the club premises at a cost of $169. (R. 79-81, 83-84.)

The taxpayer filed a timely claim for refund of the total amount of $6,917.91 paid as assessed cabaret taxes and interest. The claim was rejected in its entirety on February 11, 1946. (R. 14-15.)

The District Court found as a fact that during the period involved, the taxpayer was managing the Cozy or La Fiesta Club as a private club, organized under the laws of the State of Oregon as a non-profit corporation; that the club was not open to the public but open only to its members and their guests, and that she was not operating a roof garden, cabaret or other similar place furnishing a public performance for profit. The court thereupon concluded that the imposition of the cabaret tax under Section 1700(e) of the Internal Revenue Code, as amended, and the applicable Regulations was illegal and erroneous. (R. 15-16.) Accordingly, judgment was entered for refund to the taxpayer of $6,917.91, with interest. (R. 17.)

STATEMENT OF POINTS TO BE URGED

The District Court erred:

(1) In finding that during the period involved, the taxpayer was not operating a roof garden, cabaret or other similar place furnishing a public performance for profit.

(2) In failing to find that during the period involved, the taxpayer was operating and managing a roof garden, cabaret or other similar place furnishing a public performance for profit.

(3) In finding that during the period involved, the taxpayer was managing and operating the Cozy Club as a

private club, not open to the public, and that admission to its club rooms was open only to members and their guests.

(4) In concluding that the imposition of the cabaret tax and interest thereon assessed against the taxpayer was illegel and erroneous and not within the purview of Section 1700(e) of the Internal Revenue Code and applicable Regulations.

(5) In failing to conclude that during the period involved, taxpayer was operating a roof garden, cabaret or other similar place at the Cozy or La Fiesta Club furnishing a public performance for profit within the purview of Section 1700(e) of the Internal Revenue Code and applicable Regulations.

(6) In concluding that the taxpayer was entitled to judgment in the sum of $6,917.91, with interest.

SUMMARY OF ARGUMENT

On the facts and the law, the District Court erred in finding that the taxpayer was operating and managing the Cozy or La Fiesta Club as a private club organized as a non-profit organization and in concluding that she was not operating a roof garden, cabaret or other similar place furnishing a public performance for profit within the meaning of Section 1700(e) of the Internal Revenue Code and the applicable Treasury Regulations.

There is no dispute as to whether a performance for profit was furnished by the taxpayer, at least with respect to the period after September 17, 1943, through July 31, 1944, as the record is clear that food and refreshments were served to patrons of the club and that such patrons were permitted to dance during that period to the music of a mechanical device or juke box. The only issue of fact and of law involved is whether in her operation and management of the club, the taxpayer furnished a "public" performance for profit within the purview of the statute. Viewing the facts of record as a whole and considering the provisions of the statute and applicable Regulations, it appears clear that she did, and that the court below erred in holding otherwise.

The problem presented here is one of importance and the final disposition thereof will have a very broad application. The Bureau of Internal Revenue has been endeavoring to subject this type of business operation to the cabaret tax because such establishments are actually operating as cabarets under the guise of private clubs. The Government contends that such establishments are not bona fide clubs in any sense of the word, but instead cabarets or other similar places which cater to the public generally.

ARGUMENT

During the period involved, the taxpayer furnished a public performance for profit at the Cozy or La Fiesta Club within the meaning of Section 1700(e) of the Internal Revenue Code.

Section 1700(e) of the Internal Revenue Code, as amended, *supra,* provides that a cabaret tax shall be assessed on all amounts paid for admission, refreshment, service or merchandise at any roof garden, cabaret or other similar place furnishing a "public performance for profit", by or for any patron or guest who is entitled to be present during any portion of such performance. The term "roof garden, cabaret, or other similar place", as used in Section 1700(e), includes any room in any hotel, restaurant, hall or other public place where music and dancing privileges or any other entertainment, except instrumental or mechanical music alone, is afforded the patrons in connection with the serving or selling of food, refreshment or merchandise.

There is no dispute as to whether taxpayer furnished a performance for profit, at least with respect to the period after September 17, 1943, through July 31, 1944, the period involved here, as the record clearly shows that food and refreshments were served to patrons of the club for profit to the taxpayer, and that such patrons were permitted to dance during that period to mechanical music. Prior to September 17, 1943, dancing privileges were not furnished, because such entertainment was not permitted under the service

liquor license issued to the taxpayer by the Oregon State Liquor Control Commission. Dancing was permited only after the taxpayer obtained a restaurant license, under which license the Liquor Control Commission also permitted patrons of the establishment to dance. The only question of fact and of law in this case is whether the taxpayer in the operation and management of the Cozy or La Fiesta Club during the period involved furnished a "public" performance for profit within the meaning of the statute.

While it may be true that the Cozy Club as such was a non-profit organization in that it or its members realized no profit from its operations, it is difficult, if due consideration is given to the evidence, to conceive of any basis for the finding by the court below that the Cozy or La Fiesta Club during the period involved did not furnish a "public" performance for profit within the meaning of the statute. It must be remembered that the cabaret tax involved here was assessed against the taxpayer and not the Cozy or La Fiesta Club. The record shows that the taxpayer received as her remuneration all the profits from the sale of food, beverages, and from other sources, and paid all expenses incurred in the operation of the club. For all intents and purposes, she was the owner of the establishment operating under the guise of a private club, but which, we submit, was in reality a cabaret or other similar place open to the public.

At the time the management of the so-called club was

taken over, taxpayer purchased the physical equipment which had been owned by the prior manager and all receipts from operations, whether for so-called membership fees, dues, food, refreshments, or from other sources, became the personal property of the taxpayer. No individual member of the club, other than the taxpayer, received any profits whatever. The club had no bank account separate and apart from taxpayer's personal account. Money received from membership fees and from the sale of food, beverages and other sources was deposited either to taxpayer's general or special account. While it may be true that the membership fees thus deposited in her special account represented reimbursements to the taxpayer for money advanced to remodel and decorate the club premises, it is obvious that such expenditures actually represented improvements to her personal property used in the operation of the club, and that neither the club nor any of its members had any right, title or interest in such property.

The club facilities were advertised to the general public in several ways, one of which included the erection by the taxpayer of a neon sign outside the club building at a cost of $169. Ordinarily, members of a private club are well aware of its location and functions, except special functions, of which they are usually advised by letter, and it can hardly be said that a private club would find it necessary to use this type of advertising unless the management desired to attract the general public.

Membership in the club at a cost of $3 per year was easy to obtain. Application therefor was usually made by a person who had previously been brought to the club as a guest of a member, which application was passed on by the taxpayer and a Mrs. Sherman, who acted as secretary-treasurer of the club. The record clearly indicates that anyone who conducted himself in a satisfactory manner and who was not rowdy could become a member of the club by making an application. Enlisted personnel of the military forces were permitted to obtain a membership by the payment of only fifty cents. R. H. Lambeth, president of the club, testified that this policy was adopted because the enlisted personnel had a very limited number of places where they could take their girl friends to drink and dance. Obviously, the price of the membership was reduced for the sole purpose of attracting this potential profitable source of income because, as Mr. Lambeth testified, unless additional members were obtained, the establishment could not have remained in business. Many of the enlisted personnel obtained guest cards from the Military Police and the club was frequented by a large number of soldiers and sailors, who gained admission on their first visit by use of a guest card so obtained. Once admitted as a guest, they could go through the simple routine procedure of making application for membership and, if their conduct during the time of their first visit was good, they automatically became members. Mrs. Edith L. Deck, also a witness for the taxpayer, testified that she and

her husband became members of the club on their own applications. This tends to refute the testimony of the taxpayer that a candidate for membership had to be introduced by a member. The only privilege which a member obtained after being admitted to membership was the right to enter the club, to have a locker, and to enjoy its facilities. There is nothing in the record to show that a member had any of the usual rights or privileges which members of a private club ordinarily enjoy. The record as a whole indicates that taxpayer exercised no more discretion in admitting guests and passing on members than is exercised by the average doorman of an establishment that is operated openly as a cabaret. It is well known that doormen of many reputable cabarets and nightclubs refuse admittance to drunks, persons who are not properly dressed, persons who are not conducting themselves in a gentlemanly manner or individuals who have bad reputations.

The fact that members were permitted to bring into the club an unlimited number of guests also indicates that the club was operating as a cabaret or other similar public place. The record shows that each member was allowed to bring two guests but that if a member brought more than that number, a cover charge of seventy-five cents was made for each extra guest. This usually occurred on Friday and Saturday nights which are recognized as busy nights. On the basis of the cover charge collected from guests in excess of

two on those nights during the period involved, the record shows that an average of approximately forty extra guests were present on each of those nights. Since the seating capacity of the club dining room, where dancing was allowed, was eighty-seven persons, it will be seen that the number of members and guests present on those nights during the entire period more than equalled the full capacity of the club. Obviously, more guests were present than members. We submit that where this situation exists and continues over an extended period, such an establishment should be classified as a cabaret or other similar place, rather than a private club.

This is a case of first impression. However, it is not an isolated case insofar as the Bureau of Internal Revenue is concerned, and the final disposition of the problem presented here will have a very broad application. In many states, because of restrictions in local liquor laws, establishments that in other states would operate openly as cabarets can carry on only under the guise of private clubs. Such establishments are, of course, not bona fide clubs in any sense of the word. They are in fact cabarets which cater to the public generally. Any person who could patronize an average cabaret may become a patron by going through the ostensible process of becoming a member. Guest cards, however, are usually distributed so liberally in order to promote business that additional membership is not necessary. Even

though an establishment may fulfill the requirements necessary to be classed as a private club under local or state laws, we submit that this fact alone should not prevent the application of the cabaret tax where all the characteristics of a cabaret are present. In other words, the application of the federal cabaret tax should not be contingent upon the methods adopted by the several states in the administration of their liquor laws. If the state statutes are to govern, then uniformity in the administration of the federal cabaret tax will not be feasible.

The Bureau of Internal Revenue has been endeavoring to subject this type of business operation to the cabaret tax since it appears the intent of Congress that the tax should be applied thereto. The Bureau has consistently held that an organization is a cabaret or other similar place within the meaning of and subject to the tax imposed by Section 1700(e) of the Code where (1) food and refreshments are served for profit, (2) entertainment, such as dancing privileges, is provided, (3) the predominant purpose of the organization is the advancement of the commercial interest of the owner, manager or principal stockholder, (4) members have no equity in the profits or assets of the organization, and (5) local liquor laws are such that it is more advantageous for the organization to operate under the guise of a private club than openly as a cabaret. We submit that the facts in this case show that all of the above prerequisites are present.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the cabaret taxes and interest in the amount of $6,538.21 for the period from September 17, 1943, through July 31, 1944, were correctly assessed and collected from the taxpayer and that the judgment of the District Court, insofar as it allows a recovery of taxes paid for that period, should be reversed.

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November, 1948.